2.10 PROJECTIONS

The projections for the Italian economy presented here update – also in light of the latest cyclical indicators – those prepared as part of the Eurosystem staff macroeconomic projections published on 10 June.[1] GDP is expected to increase by 3.2 per cent in 2022, 1.3 per cent in 2023, and 1.7 per cent in 2024. Inflation is projected to fall from 7.8 per cent in 2022 to 4.0 and 2.0 per cent, respectively, in 2023 and 2024.

The macroeconomic outlook depends on how the conflict in Ukraine unfolds

The macroeconomic outlook is heavily influenced by the duration and intensity of the war in Ukraine and the effects on the Italian economy in the coming years remain highly uncertain. In the baseline scenario, it can be assumed that the conflict will drag on through all of 2022 and that its impact on commodity prices, on the degree of households' and firms' uncertainty, and on international trade will gradually lessen starting next year (see the box 'The assumptions underlying the macroeconomic scenario'). In an alternative, more adverse, scenario, the repercussions of a heightening of the tensions caused by the war would lead – starting from the third quarter of this year – to a total ban on energy commodities from Russia for twelve months, which Italy can only partly offset by finding alternative suppliers.

THE ASSUMPTIONS UNDERLYING THE MACROECONOMIC SCENARIO

The projections for the Italian economy presented here – which update those prepared as part of the Eurosystem staff macroeconomic projection exercise, published on 10 June – are based on the information available as at 8 July.

The main assumptions underlying the baseline scenario are as follows (see the table):

a) foreign demand, weighted by the various outlet markets for Italian exports, slows to 3.3 per cent on average in the three years 2022-24;

b) The euro/dollar exchange rate falls to 1.07 this year and to 1.04 in the two years 2023-24;[1]

c) the price of a barrel of Brent crude oil, based on the prices of futures contracts, falls from about $107 in 2022 to $91 in 2023 and to $84 in 2024 (from $71 in 2021). Gas prices average about €130 per megawatt hour in 2022 (€47 in 2021), €117 in 2023 and €74 in 2024. The administrative measures to limit increases in gas and electricity tariffs taken by the Italian Regulatory Authority for Energy, Networks and the Environment are also taken into account;

Table

Assumptions for the main exogenous variables

	2021	2022	2023	2024
Potential foreign demand (1)	9.6	3.7	2.8	3.4
Dollar/euro (2)	1.18	1.07	1.04	1.04
Nominal effective exchange rate (1) (3)	-0.8	2.1	0.3	0.0
Crude oil prices (2) (4)	70.7	106.9	91.3	84.0
3-month Euribor (2)	-0.5	0.2	1.6	1.7
1-year BOTs (2)	-0.5	0.5	1.4	1.5
10-year BTP yields (2)	0.8	2.8	3.6	3.8

Sources: Based on Bank of Italy and Istat data.
(1) Percentage changes. – (2) Annual averages. – (3) Positive changes indicate a depreciation. – (4) Dollars per barrel of Brent crude oil.

1 The technical assumptions on interest rates, exchange rates and oil prices are calculated based on the market prices available on 8 July.

1 For more details, see the Bank of Italy's website, 'Macroeconomic projections for the Italian economy (Eurosystem staff macroeconomic projection exercise)', 10 June 2022.

d) the three-month interest rate on the interbank market (Euribor) is equal to 0.2 per cent this year, and rises to 1.6 per cent in 2023 and to 1.7 per cent in 2024;

e) the yield on ten-year BTPs, equal to 2.8 per cent on average in 2022 (0.8 per cent in 2021), increases to 3.8 per cent in 2024, in line with the values of forward rates implied by the term structure of interest rates on government bond yields;

f) the scenario incorporates the measures in the budget law approved since January, also in response to the energy crisis, those in the National Recovery and Resilience Plan (NRRP), and those introduced in past budgets.

Interest rates rise sharply

The monetary and financial conditions underlying the baseline scenario assume that interest rates will rise, especially during the two years 2022-23, in line with market expectations of a normalization of monetary policy to counter the recent inflationary pressures. According to forward interest rates implied by the market prices available at 8 July, the yields on ten-year Italian government bonds will rise from 0.8 per cent on average in 2021 to 2.8 per cent this year (3.4 per cent in the fourth quarter) and will increase to 3.6 per cent in 2023 and to 3.8 per cent in 2024. The spread with German ten-year government bond yields, which at the start of July was at levels just below 200 basis points (see Section 2.8), is expected to rise slightly during the three-year forecasting period, to barely above 220 points in 2024. The cost of borrowing for firms, which is projected to rise by 160 basis points over the three-year period, will nevertheless remain in line with the average for the euro area.

World trade decelerates considerably

Under the baseline scenario, world trade is expected to expand relatively little over the three-year forecasting horizon, after the marked rebound in 2021 linked to the easing of restrictions imposed during the most acute phase of the pandemic. Italy's foreign demand, weighted by the outlet markets for Italian exports, is projected to increase by 3.7 per cent in 2022, thanks primarily to the carryover effect at the end of 2021, and by just over 3 per cent on average annually over the next two years.

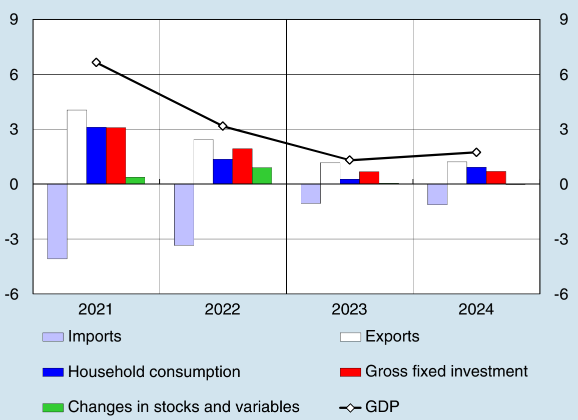
GDP continues to grow, although slowed by fallout from the war

In 2022, economic activity is expected to feel the repercussions of the conflict in Ukraine, albeit mitigated by the recovery in services as a result of the easing of restrictions. The abatement of international tensions and the progressive dissipation of inflationary pressures should spur a gradual acceleration in GDP starting in mid-2023. GDP is expected to increase by an annual average of 3.2 per cent in 2022, due largely to the carryover effect from 2021 (2.5 per cent), by 1.3 per cent in 2023, and by 1.7 per cent in 2024 (Table 12; Figure 48).

Figure 48

GDP growth and contributions of the main demand components and of imports (1)

(annual data; percentage changes and percentage points)



Sources: Based on Bank of Italy and Istat data.
(1) Data seasonally and calendar adjusted.

Fiscal policy contributes substantially to growth over the next three years

The baseline scenario incorporates substantial support for economic activity by fiscal policy and the NRRP. We estimate

Table 12

Macroeconomic scenario
(percentage changes on previous year unless otherwise indicated)

	2021	2022	2023	2024
GDP (1)	6.6	3.2	1.3	1.7
Household consumption	5.2	2.3	0.5	1.6
Government consumption	0.6	-0.6	1.3	0.4
Gross fixed investment	17.0	9.7	3.2	3.2
of which: in capital goods	12.6	6.2	3.5	5.7
Total exports	13.4	7.7	3.5	3.6
Total imports	14.3	11.2	3.3	3.4
Changes in stocks (2)	0.3	0.9	0.0	0.0
Memorandum item: GDP, raw data (3)	6.6	3.1	1.2	1.8
Prices (HICP)	1.9	7.8	4.0	2.0
HICP net of food and energy	0.8	2.9	2.1	2.1
GDP deflator	0.5	3.0	3.0	2.3
Employment (hours worked)	8.0	4.0	1.1	1.1
Employment (persons employed)	0.8	2.0	0.5	0.5
Unemployment rate (4)	9.5	8.3	8.1	8.0
Export competitiveness (5)	0.6	2.4	-0.6	0.0
Current account balance of the balance of payments (6)	2.5	-0.4	0.2	1.1

Sources: Based on Bank of Italy and Istat data.
(1) For GDP and its components: chain-linked volumes; changes estimated on the basis of quarterly data adjusted for seasonal and calendar effects. – (2) Includes valuables. Contributions to GDP growth; per cent. – (3) Not calendar adjusted. – (4) Annual averages; per cent. – (5) Calculated by comparing the price of foreign manufactures with the deflator of Italian merchandise exports (excluding energy and agricultural products); a positive value indicates a gain in competitiveness. – (6) Per cent of GDP.

that the measures introduced to help firms and households deal with rising energy prices, along with those adopted last year to soften the impact of the pandemic emergency and the interventions laid out in the NRRP could raise GDP by a total of more than 3.5 percentage points over the three years 2022-24, of which about 2 percentage points ascribable to the measures set out in the NRRP.

Employment is expected to continue to gradually increase

Employment is expected to continue to rise over the entire forecasting horizon, albeit at a slower pace than GDP. Hours worked will increase more than the number of persons employed, fostering a return to normal of the intensive margin of labour utilization. The unemployment rate is projected to fall from 9.5 per cent in 2021 to 8.0 per cent in 2024.

The pick up in consumption is hindered by inflation

After dropping in the first quarter, household consumption is expected to rise moderately through the rest of this year and the first half of the next, curbed by the impact of higher commodity prices on purchasing power – alleviated only in part by the government measures (see the box 'The distributive effects of inflation and government countermeasures') – and the drop in confidence as the war continues. The gradual abatement of inflationary pressures, which according to assumptions will coincide with the easing of tensions associated with the conflict, should stimulate greater household consumption starting in mid-2023. Overall, consumption is expected to increase by an annual average of 2.3 per cent in 2022, 0.5 per cent in 2023 and 1.6 per cent in 2024. The propensity to save, which fell to

13.1 per cent in 2021 (from 15.6 per cent in 2020), should continue to decline, approaching pre-crisis levels at the end of 2024 (Figure 49).

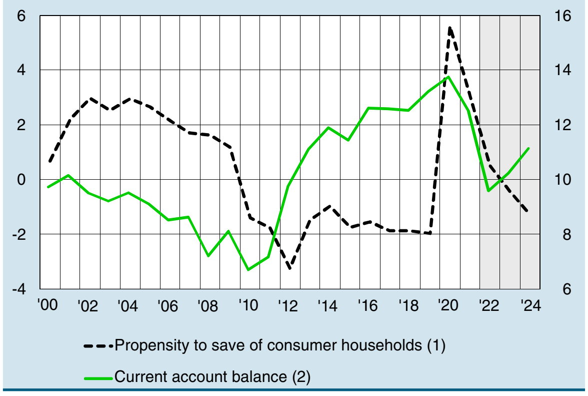
Investment benefits from economic policies but is hampered by uncertainty and higher interest rates

Investment is expected to continue to grow more robustly this year and to then decelerate over the next two years. Investment in construction is expected to keep expanding at a strong pace in 2022, thanks to building restoration incentives, but will slow progressively over the following two years. Spending on capital goods is expected to be affected by rising uncertainty and the higher cost of equity starting in the second half of this year, to then return to more sustained growth in 2024, thanks in part to the progressive implementation of the measures set out in the NRRP. The ratio of total investment to GDP should rise to around 22 per cent in 2024, just above the peak of 2007. The increase should be more marked for the capital goods component; for the construction component, in 2024, the ratio is expected to remain a little under 1 percentage point below the highest levels recorded in 2007 (Figure 50).

Figure 49

Propensity to save of consumer households and current account balance

(annual data; percentage points)

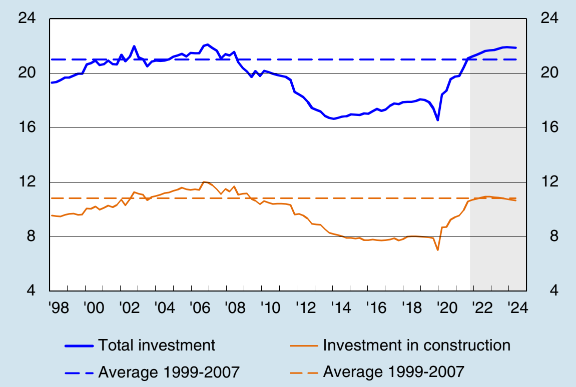


Sources: Based on Bank of Italy and Istat data.
(1) Right-hand scale. – (2) Per cent of GDP.

Figure 50

Investment as a percentage of GDP (1)

(quarterly data)



Sources: Based on Bank of Italy and Istat data.
(1) Data seasonally and calendar adjusted.

The current account reflects the sharp worsening in the energy balance

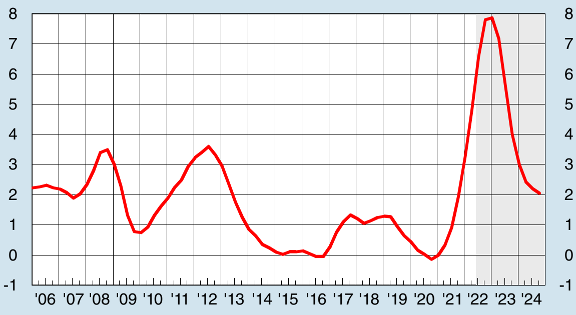
Exports are projected to increase by more than 7 per cent this year, driven by the recovery in the services component, which should benefit from international tourism flows returning to pre-pandemic levels; foreign sales should slow in the next two years, in line with weighted demand for goods and services. Imports are expected to increase more rapidly on average than exports in 2022, primarily due to a higher carryover effect at the start of this year, with the pace of growth slowing slightly in the two years 2023-24. The current account side of the balance of payments is expected to become scarcely negative this year owing mainly to the sharp worsening in the energy balance; it should turn positive again as soon as 2023 and be close to 1 per cent as a percentage of GDP in 2024.

Inflation primarily reflects higher energy prices

Consumer price inflation will likely equal 7.8 per cent on average this year, driven by the effects of the strong rise in energy prices. Smaller contributions come from supply bottlenecks and selling price adjustments in the service segments, where demand benefited the most from the easing of pandemic-related restrictions. Inflation is is projected to fall to 4.0 per cent in 2023 and to 2.0 per cent in 2024 (Figure 51). The core component, equal to 2.9 per cent this year, is expected to fall to around 2 per cent in the two years 2023-24. The progressive decline in inflation over the projection horizon reflects the assumption that the pressures stemming from rising commodity prices will ease gradually starting next year and that, also owing to the relatively long period in which collective bargaining agreements remain in force, the pass-through of these strong price dynamics to wages will happen slowly and partially. In the private sector, earnings per employee should increase by 1.0 per cent in 2022 and by 2.2 per cent on average in the following two years. Those for the public sector are expected to rise very quickly in 2022, due to renewals of collective bargaining agreements and the corresponding payment of arrears for most public sector employees, and then decline in the two years 2023-24 (owing to the absence of this latter component). Domestic inflation, measured by the GDP deflator, is likely to rise to 3.0 per cent this year and stay at that level in 2023, driven by public sector wage growth and the recovery in profit margins, to then gradually fall to just above 2 per cent in 2024.

Figure 51

Consumer price inflation (1)
(quarterly data;
percentage changes on year-earlier period)



Sources: Based on Bank of Italy and Istat data.
(1) HICP; 4-term moving averages.

Growth projections are revised downwards compared with January; projected inflation is much higher

Compared with the scenario laid out in January's *Economic Bulletin*, the growth projections have been revised downward by just over half a percentage point this year and by more than 1 percentage point for next year, as a result of the negative fallout of the conflict in Ukraine, which is affecting spending by households and firms through higher energy prices and greater uncertainty; they will remain unchanged in 2024.[2] Consumer price inflation has been revised upward considerably, by 4.3 percentage points for this year, 2.4 points for 2023 and 0.3 points for 2024.[3] The revision for the two years 2022-23 is mainly due to the trend in the energy component, while that for 2024 is attributable to higher wage growth.

The economic activity growth projections for 2022 are higher than those of the other leading forecasters; for 2023 they are close to the OECD's

Table 13

Comparison with other organizations' forecasts for Italy
(percentage changes on previous period)

	GDP (1)		Inflation (2)	
	2022	2023	2022	2023
IMF (April)	2.3	1.7	5.3	2.1
OECD (June)	2.5	1.2	6.3	3.8
European Commission (July)	2.9	0.9	7.4	3.4
Consensus Economics (June)	2.6	1.7	6.3	3.8
Memorandum item: Bank of Italy (July)	3.2	1.3	7.8	4.0

Sources IMF, *World Economic Outlook*, April 2022. OECD, *OECD Economic Outlook*, June 2022. European Commission, *European Economic Forecast. Summer 2022*, July 2022. Consensus Economics, *Consensus Forecasts*, June 2022. Banca d'Italia, *Economic Bulletin,* 3, 2022.
(1) The growth rate forecasts of the OECD are adjusted for calendar effects; those of the European Commission and IMF are not. – (2) HICP.

[2] The growth projections presented here are higher by over half a percentage point for 2022 and lower by two tenths of a point on average annually for 2023-24 compared with those published on 10 June as part of the Eurosystem coordinated projection exercise. The difference for this year is primarily attributable to the GDP figure for the first quarter published by Istat at the end of May, which was higher than expected, and to the recent positive signs regarding the performance of the industrial and service sectors in the second quarter. The difference for the next two years is a result of the impact of greater inflation on household consumption and of higher interest rates on capital expenditure.

[3] In comparison with the June estimates, inflation is higher both this year and next, by 1.6 and 1.3 percentage points respectively. The differences largely reflect a greater than expected increase in prices in May and June, in addition to generally higher commodity prices.

estimates, higher than the Commission's and lower than those of the IMF (Table 13). Inflation estimates for this year are significantly higher than those of all the leading analysts; the projections for 2023 are in line with the estimates of the OECD and higher than those of the other forecasters.

The risks to growth are on the downside

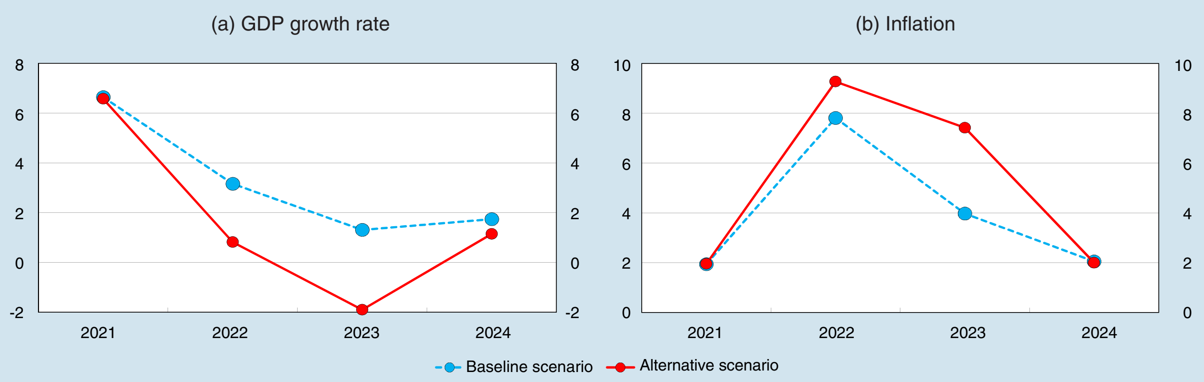
Growth forecasts are subject to considerable downside risk. The main element of uncertainty is the course of the conflict in Ukraine, which could affect commodity prices and supplies and lead to a more marked slowdown in world trade and a greater slump in confidence. In the short term, an additional risk could stem from the resurgence of the pandemic which, if it were to spread globally, could also hit international supply chains. These same factors carry upside risks for inflation, which could also be affected by a transmission, greater than has been observed historically, of higher energy prices to wages and to the less volatile components of consumer prices.

In an adverse scenario, cutting off energy supplies from Russia would cause a recession

The effects of the war in Ukraine taking an even more unfavourable course are examined in an adverse scenario, characterized by a heightening of the conflict and of tensions between Russia and the international community such as to cause an interruption in energy supplies from Russian. Under this scenario, it is assumed that: (a) as of the third quarter, imports of energy products from Russia will stop completely for one year; in our country, it would be possible, over this horizon, to replace all the foreign oil and two fifth of the natural gas[4] purchased by turning to other suppliers; the reduced availability of gas would lead to interruptions in production in the more energy-intensive industrial activities; (b) energy commodity prices would again rise significantly; (c) there would be an increase in uncertainty and a decline in confidence (similar for firms to those observed during the 2008-09 global financial crisis and for households to that in the first quarters of 2020 following the pandemic shock); (d) the growth in Italy's foreign demand is about 2.5 percentage points lower in 2022 and 4 points lower in 2023 compared with the baseline scenario.

Figure 52

Baseline scenario and alternative scenario (1)
(changes in percentage points)



Sources: Based on Bank of Italy and Istat data.

The impact of the assumptions made under the adverse scenario would erode most of the growth for the current year, in large part carried over from the end of the first quarter, bringing GDP growth to below 1 per cent in 2022, and leading to a contraction of almost 2 percentage points in

[4] For further information, see the box 'Commercial and financial relations between Italy and Russia', *Economic Bulletin*, 2, 2022.

2023 (Figure 52); GDP is projected return to growth only in 2024. The areas that would be the most penalized are household consumption, mainly because of the further decline in purchasing power, and productive investment, which would be affected by the jump in uncertainty. Foreign sales are expected to grow primarily thanks to the service component, but at much slower rates, in keeping with weakening international trade. Labour market conditions are expected to worsen again and employment is likely to fall starting from the second half of the year and for all of the following year. The unemployment rate should be at higher levels in the two years 2023-24 than those envisaged under the baseline scenario (by just over 1 percentage point). Consumer price inflation is projected to rise to 9.3 per cent in 2022, and to remain high in 2023 as well, at 7.4 per cent, decreasing significantly only in 2024.

The scenario does not include possible economic policy responses, whether at national or European level, that could be taken to mitigate the impact of the hypothetical developments on households and firms.